No. 758

In the

Supreme Court of the United States

October Term, 1946

Joseph W. Frazer,

Petitioner,

v.

Commissioner of Internal Revenue,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

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SUBJECT MATTER INDEX

STATUTES CITED.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

To the Honorable Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Joseph W. Frazer, respectfully prays for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit to review a judgment of that court entered on September 9th, 1946, affirming a decision of The Tax Court of the United States, entered on July 12th, 1945, which determined that there was a deficiency in income tax on the part of the petitioner in the amount of $18,102.84 for the calendar year 1939 (Appendix, pp. 20-26).

Statement of Matters Involved

Your petitioner was a beneficiary of two non-exempt employees' trusts which had been created in 1929 and 1936 by Chrysler Corporation (hereinafter referred to as Chrysler) for the benefit of certain of its officers and executives (R. 31, 70). Chrysler made contributions to the trusts an-

nually computed upon stipulated percentages of its net profits (R. 32, 53, 63, 72). The petitioner terminated his employment with Chrysler in January of 1939 (R. 20) and, pursuant to the provisions of the said trusts, surrendered his interests therein and was paid his proportionate amount of the net assets of the trusts in accordance with the trusts' provisions (R. 26-28).

In his income tax return for 1939 the petitioner reported the net proceeds realized by him on the final distribution as capital gain and paid the tax thereon. The respondent asserted the deficiency in tax upon the theory that petitioner was in receipt of ordinary income.

The Tax Court of the United States sustained the respondent and held that the distributions in 1939 by both non-exempt employees' trusts were compensation paid to the petitioner in that year notwithstanding that the contributions had been made to the trusts in prior years.

The case was presented to The Tax Court of the United States on stipulated facts. The stipulations showed in substance as follows:

Under each trust agreement a committee was empowered to select those officers or employees of Chrysler who were to be permitted to participate as beneficiaries. The committees also were to fix the number of shares in each trust which the selected employees were allowed to purchase (R. 37, 79). The first trust was divided into 30,000 shares of beneficial interest, each of which was offered to the selected employees at $25 per share (R. 35, 38) and the second trust was divided into 13,000 shares of beneficial interest, each of which was offered at $7.00 per share (R. 76, 79).

In addition to the annual percentages of profits which Chrysler agreed to contribute, it also agreed to lend the trusts substantial sums of money for the purchase of shares of Chrysler common stock (R. 32, 52). The income of the trusts consisting of dividends and interest was

to be placed in an account called Surplus "A". The income consisting of Chrysler's annual contributions and gains from the sale of securities was to be credited to an account called Surplus "B" (R. 34, 75-76).

The reason for the division of trust income into these two accounts was that whereas the beneficiary had a 100% vested interest in his share of the Surplus "A" account, he had only an 80% vested interest in his share of the Surplus "B" account in the event that his employment with Chrysler terminated by reason of his own fault (R. 39, 80-1). The petitioner purchased 400 shares of beneficial interest in the first trust at $25 per share, October 8th, 1929 (R. 23). He purchased 50 shares of beneficial interest in the second trust at $7.00 a share on November 19th, 1936 (R. 25-6). He remained a beneficiary until the termination of his employment in 1939, having received various distributions from time to time in the intervening years out of the Surplus "A" and Surplus "B" accounts of both trusts. The aggregate of these distributions had exceeded the petitioner's investment in the aforesaid shares of beneficial interest (R. 29, 128).

The trust instruments originally provided that upon the death or retirement of an employee his interests in the trusts terminated and his shares were required to be surrendered to Chrysler for payment in accordance with the formula specified in the trusts (R. 39, 80). By agreement dated December 2nd, 1938, voluntarily entered into by the beneficiaries, the trustees and Chrysler, the trust indentures were amended so that thereafter the shares of a beneficiary who died or whose employment terminated were required to be surrendered to the trustees instead of to Chrysler. The formula for computing the amount payable to a beneficiary for his shares remained unchanged (R. 65, 91).

On these facts The Tax Court of the United States found that the contributions which Chrysler made to the

trusts in each year were intended as additional compensation for the beneficiaries and that in 1939 the petitioner received such compensation, taxable as ordinary income, as to all such contributions accumulated by the trustees. Petitioner contended below that assuming that these contributions were intended as compensation, they were taxable, not in 1939 when distributed by the trusts, but in the respective years of payment to the trustees since the trusts were non-exempt employees' trusts and the interests of the beneficiaries were vested and non-forfeitable. In the alternative, petitioner contended that the surrender of his shares constituted a sale or exchange under Section 117 resulting in capital gain, as reported by him in his tax return. The petitioner also contended below that he could not have been in receipt of compensation in 1939 with respect to that part of the final distribution which consisted of the appreciation in value of the shares of Chrysler common stock which had been purchased by the trustees with borrowed or other funds.

The Circuit Court of Appeals, with Judge Miller dissenting, affirmed The Tax Court's decision and held that the surrender of petitioner's shares was not a sale or exchange, that each trust was a mere conduit by which compensation passed from Chrysler to the petitioner in 1939.

Jurisdiction

The jurisdiction of this Court is invoked under the Judicial Code, Section 240(a) (U. S. C., Title 28, Section 347a).

Questions Presented

I. Did the courts below err in ruling that petitioner, as the beneficiary of non-exempt employees' trusts whose interests therein were vested and non-forfeitable, realized income as compensation in the year of final distribution by

the trusts rather than in each prior year when contributions were made to the trusts by the employer?

II. Did the courts below err in ruling that the surrender by the petitioner of his shares of beneficial interest in the trusts did not constitute a sale or exchange resulting in capital gain under Section 117 of the Internal Revenue Code?

III. Did the courts below err in ruling that that part of the distribution by the trusts consisting of appreciation in the value of shares of Chrysler common stock purchased by the trusts with borrowed or other funds was compensation taxable to the petitioner as ordinary income?

Reasons for Allowance of Writ

I. The decision in the instant case is in direct conflict with other holdings of The Tax Court of the United States (*J. H. McEwen* v. *Commissioner,* 6 T. C. 1018; *David W. Anderson* v. *Commissioner,* 5 T. C. 1317; *Julian Robertson* v. *Commissioner,* 6 T. C. 1060; *D. D. Hubbell* v. *Commissioner,* 3 T. C. 626) and with a prior decision of the Circuit Court of Appeals for the Sixth Circuit (*Hubbell* v. *Commissioner,* 150 Fed. (2d) 516, affirming 3 T. C. 626) that a beneficiary of a non-exempt employees' trust whose interest is non-forfeitable realizes income in the respective years when contributions are made by his employer and not in the year of final distribution.

II. The decision rendered in this case conflicts with the decisions previously rendered by the Circuit Court of Appeals for the Second Circuit (*Schaefer* v. *Bowers,* 50 Fed. (2d) 689, certiorari denied 284 U. S. 668, 52 S. Ct. 42) and by The Board of Tax Appeals (*K. R. Kingsbury* v. *Commissioner,* 31 B. T. A. 1126) on the issue that retention

by trustees of title to assets contributed by an employer does not prevent realization of income by an employee-beneficiary whose rights are vested.

III. The decision in the instant case is in conflict with a prior decision of the court below (*Estate of Frederick L. Alldis* v. *Commissioner of Internal Revenue,* 142 Fed. (2d) 885) which held that the surrender of the shares of beneficial interest of a deceased beneficiary of the same Chrysler trusts resulted in capital gain.

IV. The questions in issue are of great importance. Numerous employees' trusts which have been created in recent years will be affected by the decision in the instant case. Section 165(c) of the Internal Revenue Code, as amended by the Revenue Act of 1942, contains an express provision to the effect that employer contributions to non-exempt trusts are taxable to the beneficiaries whose interests are non-forfeitable. It has been held that this amendment contains no apparent change in Congressional purpose and is, therefore, applicable to trusts, such as the Chrysler trusts, which were in existence prior to the adoption of the amendment. Unless the decision of the court below is reversed it will stand as a precedent for the proposition that final distributions by non-exempt trusts to employees whose interests are non-forfeitable are taxable in the year of such final distributions rather than in the years when the contributions were made.

Because of the clear conflict which exists between the cases cited above and because of the importance of the question involved to the great many of beneficiaries of employees' trusts as well as to other beneficiaries of these Chrysler trusts, it is important that this Court settle the questions thus raised.

WHEREFORE, your petitioner prays that a writ of certiorari may issue out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Sixth Circuit, commanding the said Court to certify and send to this Court this cause and a complete transcript of the record and of all proceedings had herein; to the end that this cause may be reviewed by this Court; that the judgment of the said United States Circuit Court of Appeals be reversed and that the petitioner may have such other and further relief in the premises as this Court may deem appropriate.

Dated: November 29, 1946.

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Petitioner.

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In the

Supreme Court of the United States

October Term, 1946

Joseph W. Frazer,

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Commissioner of Internal Revenue,

Respondent.

BRIEF IN SUPPORT OF PETITION

Opinions Below

The opinion rendered by The Tax Court of the United States in this case is reported in 4 T. C. 1152.

The opinion of the United States Circuit Court of Appeals for the Sixth Circuit is officially reported in 157 Fed. (2d) 282. It is annexed to the certified transcript of the record filed herein and is also reprinted in the appendix to this petition (pp. 20-26).

Jurisdiction

The judgment of the Circuit Court of Appeals now sought to be reviewed was entered on September 9th, 1946. The jurisdiction of this Court is invoked under the Judicial Code, Section 240(a) (U. S. C., Title 28, Section 347a).

Statement of the Case

A summary statement of the case is set forth in the petition. A summary of the argument is likewise presented in the petition.

Specification of Assigned Errors

The Circuit Court of Appeals erred:

I. In holding that the final distributions made by the Chrysler trusts to the petitioner in 1939 constituted compensation to him in that year taxable as ordinary income.

II. In holding that the distributions to the petitioner in 1939 of contributions paid by Chrysler to the trusts in prior years did not constitute taxable income to the petitioner in the respective prior years when received by the trusts.

III. In the alternative, in holding that upon the surrender by the petitioner of his certificates of beneficial interest in the trusts he did not realize capital gain under Section 117.

IV. In holding that that part of the distributions to the petitioner in 1939 consisting of appreciation in the value of Chrysler shares of common stock purchased by the trustees with borrowed or other funds constituted compensation to the petitioner and taxable to him as ordinary income in that year.

ARGUMENT

POINT I

Since the Chrysler trusts were non-exempt employees' trusts and the petitioner's interests therein were non-forfeitable, the court below erred in holding that the final distributions upon the surrender of his shares constituted compensation taxable to the petitioner in that year rather than in the prior years when the contributions were made.

The Chrysler trusts which are the subject of this petition have been before the courts in three other cases. On each occasion, as well as in the case at bar, the trusts were interpreted as pure trusts and not tax-exempt trusts subject to Section 165 of the Internal Revenue Code.

> *Chrysler Corporation* v. *Commissioner of Internal Revenue,* 42 B. T. A. 795;
> *Estate of Frederick L. Alldis* v. *Commissioner of Internal Revenue,* 46 B. T. A. 1171, aff'd (C. C. A. 6) 142 Fed. (2d) 885;
> *Commissioner of Internal Revenue* v. *Kilpatrick's Estate* (C. C. A. 6), 140 Fed. (2d) 887.

Indeed, in the Alldis case the respondent on appeal abandoned the contention raised in the Board of Tax Appeals that the trust was not a pure trust.

In every reported case in which an employer has made contributions to a non-exempt trust the contributions have been held taxable to beneficiaries whose interests were non-forfeitable in the years when contributed.

> *J. H. McEwen* v. *Commissioner,* 6 T. C. 1018;
> *David W. Anderson* v. *Commissioner,* 5 T. C. 1317;

Julian Roberston v. *Commissioner,* 6 T. C. 1060; *D. D. Hubbell* v. *Commissioner,* 3 T. C. 626, aff'd in 150 Fed. (2d) 516.

The McEwen and Robertson cases are directly in point and would appear, except for the decision herein in the court below, to represent the law in this type of case. In the McEwen case The Tax Court expressed the fundamental principle governing the taxability of contributions under such circumstances in the following clear language:

> "Whether the employee or a trustee is given the possession of an annuity contract is not determinative of the issue whether the premium paid therefor is income to the employee under section 22(a). The question is, was 'any economic or financial benefit conferred on the employee as compensation' in the taxable year? If it was, then the form or mode by which such benefit is effected is not important."

In *Hubbell* v. *Commissioner, supra,* the court below had before it a non-exempt employees' trust which for all practical purposes was similar to the trusts involved in this case. In holding that the contributions to the non-exempt trust were taxable to the employee in each year when paid to the trusts by the employer, the court said:

> "The Tax Court found that the creation of the trust and the purchase of the annuity contracts by the optical company was a device to provide additional compensation to the petitioners and defer the tax on such compensation, rather than a plan to provide for their future security. There was no prohibition in the trust agreement against assignment of the annuity contracts, or the benefits thereunder; nor was there any provision against the taxpayers' obtaining the cash surrender value of the policies *upon leaving the employ of the optical company at any time.* Payment of specified cash surrender values was provided for in the policies. The duties of the trustee were merely ministerial. As well reasoned by The Tax Court, the only actual duty devolving upon the trustee was to prevent a trust bene-

ficiary from withdrawing the cash surrender value of the policy *while in the employ of the optical company*. The trustee was truly a mere conduit."

The language there used by the court below was similar in most respects to the opinion in the instant case, but the result was the very opposite. Speaking of the Chrysler trusts and the annual contributions made thereto, the court below in the instant case said:

> "* * * The trusts were 'truly a mere conduit' by which compensation passed from Chrysler to petitioner".

What material distinction can possibly be drawn between these cases? In each year Chrysler parted irrevocably with its contributions and was allowed tax deductions therefor upon the ground that they constituted compensation paid to employees (see *Chrysler* v. *Commissioner, supra*). The interests of the beneficiaries could under no circumstances be defeated by any condition subsequent, except to the extent of 20% of their respective shares in the Surplus "B" account. The beneficiaries had 100% vested interests in the Surplus "A" account (interest and dividends) and a minimum of 80% in the Surplus "B" account (contributions and profits on sale of stock). Only in the event that his employment terminated by reason of his fault could the other 20% interest in the Surplus "B" account be denied to a beneficiary. It is perfectly clear, therefore, that in each year of the existence of these trusts the petitioner acquired an immediate vested interest in no less than 80% of Chrysler's contribution.

We have then this situation: A non-exempt trust is created for the benefit of executives; the employer pays additional compensation to the employees, using the trusts as a mere conduit; the employer has no further interest in the contribution after payment to the trust and receives a tax deduction therefor; and the employees' interest in the trust assets is vested and non-forfeitable. Assuming, therefore, as the courts below have found, that the trusts were a

form or device for routing additional compensation to such employees, can it be held under the present state of our tax laws that compensation was not realized by the employees in the year of the employer's contribution?

Section 165(c), as amended by the Revenue Act of 1942, provides that under such circumstances the employee realizes taxable income "at the time the contribution is made". In considering the applicability of this section to prior tax years, The Tax Court said in *David W. Anderson* v. *Commissioner, supra*:

> "The present statutory scheme of taxing the employee on the employer's contribution in the year made, when the trust is not exempt, is but in accord with the result reached in the *Hubbell* case, *supra,* which arose under the prior law. Furthermore, in that case the court said that the 1942 amendment presented 'no apparent change in Congressional purpose'."

We have found no case of record in which a contribution to a non-exempt trust was not held taxable to the beneficiaries in the year of the contribution, except in instances where the employees' rights were conditional. (See *Robertson* v. *Commissioner, supra.*)

Contributions by Chrysler were made to the trusts in almost all years commencing with their creation in 1929 and 1936, respectively. The trustees proceeded to invest these funds for the benefit of the beneficiaries and from time to time distributed income therefrom. Although the beneficiaries could not dispose of their interests to anyone other than Chrysler or the trusts they had every other conceivable economic benefit or gain which might be realized therefrom. The funds upon receipt by the trustees were invested for their account. The proceeds of the investments were similarly credited or distributed to them. Possession of the employer's contribution was the only thing denied to the beneficiaries. In all other respects the beneficiaries' interest therein, including the enjoyment of the profits thereon, were made available to them.

The retention of title by trustees of a non-exempt trust does not prevent the realization of income by an employee when his rights are vested.

> *K. R. Kingsbury* v. *Commissioner,* 31 B. T. A. 1126, 1137 (Acquiescence XIV-1 C. B. 11);
> *Schaefer* v. *Bowers,* 50 Fed. (2d) 689.

In the *Kingsbury* case the Board said:

> "It is clear that the underlying and motivating reason for paying the 'bonus', or additional compensation, to the officers was to induce them to remain with the company for five years. At the moment that condition was fulfilled the officers became possessed of a valuable right which unquestionably was property. Retention of the title by the trustee did not affect the rights so acquired or prevent their vesting. *Henry* v. *United States,* 251 U. S. 393; *Schneider* v. *Duffy,* 43 Fed. (2d) 642; *Shaefer* v. *Bowers,* 50 Fed. (2d) 689, and cases there cited."

The *Schaefer* case expressed the principle that if the right of an employee to his employer's contribution is conditional, he is not in receipt of taxable income; but if his interest cannot be defeated he is taxable even though legal title may repose in the trustees. A taxpayer may realize economic gain even though that gain is not actually collected by him (*Helvering* v. *Stuart,* 317 U. S. 154, 63 S. C. T. 140, 148). Nor does the restriction against transfer of the petitioner's interest to anyone except Chrysler and, after the amendment, to the trustees, negative the existence of value in petitioner's share of the contribution; at most the restriction reflected upon the value of the thing received (*Rodriquez* v. *Edwards,* C. C. A. 2, 40 Fed. (2d) 408).

The issue is not unlike that in the cases involving delivery to an employee of non-assignable, non-surrenderable annuity contracts. The paper evidencing the annuity contract, in such cases, was no different than the certificates of beneficial interest held by the petitioner in the case at bar. The

cases are uniform in their holding that such annuity contracts are, nevertheless, taxable income in the year of delivery by the employer (*Renton K. Brodie* v. *Commissioner,* 1 T. C. 275; *J. Ferd Oberwinder* v. *Commissioner,* C. C. A. 8, 147 Fed. (2d) 255; *Paul A. Draper* v. *Commissioner,* 6 T. C. 209).

In the Oberwinder case the Circuit Court made an appropriate observation which sums up all argument that may be made as to the year when taxable income is realized in this type of case. The court there said:

> "It cannot be said that on their receipt the petitioners realized no economic gain. *Helvering* v. *Stuart, supra.* On the delivery of the contracts it was certain that the petitioners or their assigns would eventually receive the full amount expended by the company in the purchase of the contracts."

As a beneficiary of the Chrysler trusts the petitioner had every economic gain from each year's contribution as the same was made to the trusts. Since the payments constituted additional compensation and his rights thereto could not be defeated, they comprised taxable income and should have been reported as such in each year. That neither the Commissioner of Internal Revenue nor the taxpayer so interpreted the law in those years is no justification for holding that the entire accumulation of contributions distributed in a single year upon the termination of the petitioner's interest constituted compensation paid to him in that year. None of the cited authorities supports that harsh and oppressive interpretation of the law.

The decision in the instant case is the only one of record, to the petitioner's knowledge, which holds an employee taxable under such circumstances in the year of distribution rather than in the year of contribution. Unless the decision in this case is reversed, it will stand as an authority in direct opposition to the holdings of those other cases cited herein and will cause great doubt and confusion to many thousands of beneficiaries of similar trusts.

POINT II

The courts below erred, in any event, in holding that the final distributions to the petitioner upon the surrender of his beneficial interests resulted in ordinary income rather than capital gain.

Alldis, like Frazer, was an executive of Chrysler and a beneficiary of one of the aforesaid trusts (*Estate of Frederick L. Alldis* v. *Commissioner of Internal Revenue, supra*). Upon his death his shares of beneficial interest were surrendered for payment in accordance with the trust provisions. As in the instant case, the executors of the Alldis Estate reported the proceeds received on the surrender of these shares as capital gain, and the Commissioner sought to tax the same as ordinary income. In the *Alldis* case, The Board of Tax Appeals and the court below held that the surrender of the Alldis shares resulted in capital gain; in the instant case on identical facts both of the courts below reached the very opposite conclusion.

The Board, after deciding that the Chrysler trusts were not tax exempt under Section 165, held that the Alldis shares of beneficial interest "constituted a property interest and as such a capital asset", notwithstanding that the proceeds received on the surrender of the shares consisted of Chrysler's annual contributions paid to the trusts as additional compensation.

In the case at bar the dissenting opinion of Judge Miller in the court below considered the identical facts involved in both cases and said:

> "I believe the previous ruling of this court in *Commissioner* v. *Alldis' Estate,* 140 Fed. (2d) 885 is applicable and should be followed.
>
> "It was there held that the amount received by the Administrator for the certificates owned by the decedent resulted in a capital gain rather than receipt of income. The interest of the owner of certificates is the same regardless of how that interest is terminated, by

> death or by termination of employment. In either event that interest ceases and is liquidated. I see no material difference in its liquidation by transfer to the corporation, as in the *Alldis* case, and in its liquidation by surrender to the Trustees, as in this case. In both instances he receives the then cash value of his interest in the trust. In any event, the increase in market value of the assets of the trust is not receipt of income. In my opinion, the amount received by the taxpayer for his certificates upon termination of his employment should be treated as a capital gain rather than receipt of income."

The majority distinguished the Alldis case upon the ground that here the beneficiary could not sell or transfer his shares to any party except the trustees, that he could only surrender them to the trustees in accordance with the trust provisions and that he received no consideration for the certificates when he returned them. This is an oddly strained interpretation of the facts which, if true, was equally applicable to the Alldis shares. Alldis could not sell or transfer his shares except to Chrysler; and it must be remembered that the proceeds were additional compensation paid to the trusts as "a mere conduit" and could be obtained by the beneficiary only by surrendering his shares to Chrysler. The device for routing compensation through the trusts was neither more nor less of a device because surrender of the Alldis shares was required to be made to Chrysler rather than to the trustees. In either event, the beneficiary was payable the amount computed under the formula specified in the trusts. Moreover, as pointed out above, a provision restricting the transfer of an asset does not deprive it of its character as a capital asset but merely affects the value thereof.

The majority opinion below also argued that no consideration was received by Frazer for his certificate since there was nothing in the trust instruments to indicate that he was entitled to any. The court not only ignored the fact of petitioner's vested and non-forfeitable interest in the trust

assets but it overlooked the prior interpretation of The Board of Tax Appeals in the *Alldis* case, later affirmed by the court below, which specifically held that "those shares represented an interest owned by the decedent in trust assets, which interest, by the terms of the trust indenture, was specifically made assignable to the corporation for the cash value thereof."

The decisions in the *Alldis* case and in the case at bar are irreconcilable. The facts were identical, yet opposite results were reached by the same courts. Is the share of a deceased beneficiary any more of a capital asset than that of a retiring beneficiary? How shall the courts in other cases involving Chrysler beneficiaries treat the surrender of their shares? Shall preferential treatment be given in the case of deceased employees and shall it be held that they are owners of capital assets, upon the surrender of which capital gain is generalized, while retiring employees have nothing which is capable of transfer? The result of the cited cases is clearly contradictory and confusing. The dissenting opinion of Judge Miller holding that the interests of the beneficiaries in both instances are the same is the only logical and consistent result to be employed in these cases.

The courts below ignored petitioner's contention that in no event could the appreciation in the value of Chrysler stock purchased by the trustees with borrowed funds be treated as compensation to the petitioner on the final distribution. No explanation for this bizarre result can be found in the opinions of both courts. Having determined that the Chrysler annual contributions of net profits constituted compensation routed through the trusts, the courts below lumped all other distributions in the same category. No authority can anywhere be found in support of this capricious handling of what in every other instance of appreciation in the value of investments would constitute capital gain. The petitioner purchased his shares in the

trusts for cash and at least part of the trustees' unrealized gain on Chrysler common stock was the result of investment of capital funds. The determination that no part of the final distribution to the petitioner was capital gain has no support in the law.

Conclusion

It is, therefore, respectfully submitted that this Court grant the petition for certiorari so that it may settle the conflicting decisions of the courts respecting the issues presented herein and prevent the harsh and oppressive result to the petitioner in the case at bar.

Respectfully submitted,

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APPENDIX

Opinion

No. 10172

UNITED STATES CIRCUIT COURT OF APPEALS

SIXTH CIRCUIT

JOSEPH W. FRAZER, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	On Petition to Review a Decision of the Tax Court of the United States.

Decided September 9, 1946.

Before HICKS, MARTIN and MILLER, Circuit Judges.

HICKS, Circuit Judge. Petition of Joseph W. Frazer to review a decision of the Tax Court assessing against him a deficiency in income tax for the year 1939 in the amount of $18,102.84.

The evidence before the Tax Court consisted of stipulated facts.

Petitioner filed his return for 1939 on the cash receipts and disbursements basis. He had been an executive of Chrysler Corporation (herein called Chrysler) from 1929 through all subsequent years until his resignation on January 19, 1939.

Appendix.

On April 16, 1929, Chrysler executed a Trust Indenture known as "Chrysler Management Trust." The parties to it were (1) Chrysler; (2) the holders of certificates of beneficial interest; and (3) designated trustees who were managers of the Trust. The Trust was established pursuant to the plan of Chrysler "to attract and retain desirable officers and/or executives and to insure the permanency of sound and efficient management of the Corporation * * * by enabling such officers and/or executives to become owners of stock of the Corporation on a basis favorable to them. * * *"

The detailed provisions of the trust instrument are set out in our opinion in *Commissioner* v. *Alldis' Estate*, 140 Fed. (2d) 885. This instrument was amended from time to time.

On April 11, 1936, Chrysler executed a second trust indenture called "First Adjustment Chrysler Management Trust." The purposes of each Trust were substantially the same. Each had its "Bonds" or "Finance" Committee which was empowered to select the executives or officers of Chrysler, who were to be permitted to share as beneficiaries. The holdings of each were to consist of a percentage of Chrysler's earnings which it agreed to pay each year and funds which Chrysler loaned to the trusts with which to buy Chrysler common stock as an investment. The trustees were empowered at their own discretion to make distributions to the beneficiaries out of surplus earnings of the trusts. They were required to maintain two surplus accounts, identified as "A" and "B." To surplus "A" was credited all moneys received as interest, dividends and similar income from funds of the trusts; and to surplus "B" was credited the annual payments received from Chrysler, together with profits arising from the sale or conversion of stock or other securities or property.

According to the provisions of the first trust, the petitioner, on October 8, 1929, acquired 400 shares of the beneficial interest therein at $25.00 per share for which he paid $10,000.00 in cash. According to the provisions of the second trust, petitioner on November 19, 1936, acquired certificates for 50 shares of beneficial interest therein at a price of $7.00 per share for which he paid $350.00.

During the years, 1936, 1937 and 1938, the petitioner received various distributions from the trustees of the first trust, from current earnings of the trust for those years and from earlier years. On January 19, 1939, the petitioner received from the trustees the following amounts:

400 shares Chrysler Management Trust:	
Return of petitioner's original cost ..	$ 8,000.00
Aliquot portion of "Surplus A" account	110.73
80% of aliquot portion of "Surplus B" account	46,494.50
	$54,605.23
50 shares First Adjustment Chrysler Management Trust:	
Return of petitioner's original cost ..	$350.00
Aliquot portion of "Surplus A" account	70.83
Aliquot portion of "Surplus B" account	4,727.71
Dividend	800.00
	$ 5,948.54

Immaterial matters to one side, the question before the Tax Court was, whether any part of this total of $60,553.77 represented taxable income to petitioner. It held that petitioner was taxable upon that portion of the amounts received by him which represented earnings paid by Chrysler to the trusts because these earnings represented

ordinary and necessary expenses of Chrysler incurred as compensation for services rendered by petitioner. These payments by Chrysler to the trustees were in discharge of its obligation to the trustees under the Trust Indentures.

There is no controversy over what percentage of the amounts received by petitioner represented earnings paid by Chrysler to the trusts; and further, there is no controversy that these payments were intended to be compensation to the beneficiaries for services rendered, and intention is a controlling consideration. *Mason* v. *Commr.*, 125 Fed. (2d) 540, 542 (CCA 6) and cases there cited.

From our viewpoint there is "a rational basis for the conclusions" reached by the Tax Court. *Dobson* v. *Commr.*, 320 U. S. 476, 501.

We have already quoted from the preambles of each trust. By the trust provisions the petitioner, upon his resignation, was required to and did surrender his shares of beneficial interest (the cost of which he had received through distributions) to the trustees, who settled with him as above indicated. He could not, under the terms of the trusts, otherwise transfer or assign these shares, nor could he retain them after his employment ceased. The amounts paid him included, among other items, his proportion (estimated by the number of his shares) of annual contributions which Chrysler had made to the trusts from its earnings.

There can be no doubt that Chrysler intended its contributions to the trusts as additional compensation to its officers or executives, who held shares of beneficial interest in the trust estate. This was the attitude assumed by Chrysler itself in *Chrysler Corporation* v. *Commr.*, 42 BTA 792, wherein it successfully sought to have these contributions deducted as ordinary and necessary expenses incurred under Sec. 22(a) of the Revenue Act of 1934.

This Section 22(a) defines "gross income" as "including * * * gains, profits and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid. * * *" (Italics ours.) It is broad enough to include as taxable income the amounts received by petitioner as compensation. *Commissioner* v. *Smith*, 324 U. S. 177, 181; *Old Colony Trust Co.* v. *Commr.*, 279 U. S. 716, 729; see also Treas. Reg. 103 [Article 19.22(a)—].

Petitioner contends that the contributions by Chrysler to the trusts were income to the trusts and therefore taxable to them and not to him. A short answer is, that they were not income to the trusts, since, according to Article 1 of the Chrysler Management Trust, the trusts were "truly a mere conduit" by which compensation passed from Chrysler to petitioner. The contributions were not earnings of the trusts. *Hubbell* v. *Commr.*, 150 Fed. (2d) 516, 529 (CCA 6); *Parkford* v. *Commr.*, 133 Fed. (2d) 249, 251 (CCA 9).

It is urged by petitioner that in any event he is not taxable in 1939 upon distributions received by the trustees in prior years. We are not in accord. Petitioner made his returns on the cash receipts and disbursements basis and neither constructively nor actually received the contributions until 1939, in which years he made his settlement with the trustees. Under the trust agreements he was not entitled to and did not receive them until his resignation as an executive on January 19, 1939.

Petitioner contends that the amounts paid to him on the surrender of his shares of beneficial interest were either a tax-free distribution of principal, or were received on the sale or exchange of capital assets, and consequently not taxable as ordinary income. The evidence on the point does not refute or negative the findings of the Tax Court based upon substantial evidence. No part

of the earnings of Chrysler paid to the trustees became an asset of petitioner until distributed by the trustees and the distribution was not made as a consideration for the purchase of petitioner's shares or in exchange therefor. Under the terms of the trust indentures, as amended (see Exhibit E to the stipulation of facts) petitioner ceased to be a beneficiary upon his resignation. He could not sell his shares or transfer them to any other party except to the trustees. He could only surrender them to the trustees in accordance with the provisions of the trusts. He received no consideration for the certificates when he returned them, and there is nothing in the trust instruments to indicate that he was entitled to any; but he did receive his share of the trust estate as computed by the trustees.

We find nothing in *Commissioner* v. *Alldis, supra,* in conflict with our conclusion. Alldis died on January 27, 1938, the owner of 100 shares of beneficial interest in the Chrysler Management Trust. His administratrix surrendered these shares to the Chrysler Corporation for $56,472.20, which amount she reported and upon which she reported a taxable income. She paid the tax and filed a claim for a refund which the Commissioner rejected; whereupon she brought suit to recover. We held that under the trust provisions the corporation was not required to pay the administratrix until she, within one year after decedent's death, should "surrender, transfer and assign to the corporation his * * * certificates for shares of beneficial interest." She did surrender the shares in 1938 and received the sum above indicated. This court held that the amount so received was not taxable to the estate of Alldis in 1938 because Sec. 42 of the Revenue Act of 1938 provides that "in the case of the death of a taxpayer there shall be included any computed net income for the taxable period in which falls the date of his death amounts accrued

up to the date of his death if not otherwise properly includible in respect of such period or a prior period." (Italics ours.)

Clearly, the *Alldis* case is not applicable here. Petitioner ceased to be a beneficiary upon his resignation on January 19, 1939. He then surrendered his shares of beneficial interest and was paid by the trustees as above indicated. Assuming the correctness of our conclusion that such portion of the payment to him represented compensation for services rendered, it was includible in petitioner's 1939 return which was made for the calendar year, because it was paid to him in that period.

The decision of the Tax Court is affirmed.

Miller, Circuit Judge (dissenting in part). I believe the previous ruling of this court in *Commissioner* v. *Alldis' Estate,* 140 Fed. (2d) 885 is applicable and should be followed.

It was there held that the amount received by the Administrator for the certificates owned by the decedent resulted in a capital gain rather than receipt of income. The interest of the owner of certificates is the same regardless of how that interest is terminated, by death or by termination of employment. In either event that interest ceases and is liquidated. I see no material difference in its liquidation by transfer to the corporation, as in the *Alldis* case, and in its liquidation by surrender to the Trustees, as in this case. In both instances he receives the then cash value of his interest in the trust. In any event, the increase in market value of the assets of the trust is not receipt of income. In my opinion, the amount received by the taxpayer for his certificates upon termination of his employment should be treated as a capital gain rather than receipt of income.